

year, he is paid a lump sum in settlement of all future annuity payments, the capital gains treatment does not apply to such lump sum settlement paid during the lifetime of the employee since it is not a payment on account of separation from the service, or death after separation, but is on account of the settlement of future annuity payments.

(4) If the "total amounts" payable under all annuity contracts under the plan with respect to a particular employee are paid or includible in the gross income of several payees within one taxable year on account of the employee's death or other separation from the service or on account of his death after separation from the service, the capital gains treatment is applicable. Thus, if the balance to the credit of a deceased employee under all annuity contracts provided under an annuity plan becomes payable to two payees, the capital gains treatment is applicable provided the "total amounts" payable are received by or includible in the gross income of both payees within the same taxable year. However, if the "total amounts" payable are made available to each payee and one elects to receive his share in cash while the other makes a timely election under section 72(h) to receive his share as an annuity, the capital gains treatment does not apply to either payee.

(5) For purposes of determining whether the total amounts payable to an employee have been paid within one taxable year, the term "total amounts" includes amounts under a plan which are attributable to contributions on behalf of an individual while he was self-employed in the business with respect to which the plan was established. Thus, the "total amounts" payable are not paid within one taxable year if amounts remain payable which are so attributable.

(6) The term "total amounts" does not include any amount which has been placed in a separate account for the funding of benefits described in section 401(h). Thus, a distribution under a qualified annuity plan may constitute a distribution of the total amounts payable with respect to an employee even though amounts attributable to the funding of section 401(h) medical

benefits as defined in paragraph (a) of § 1.401-14 are not so distributed.

(c) The provisions of this section are not applicable to any amounts paid to a payee to the extent such amounts are attributable to contributions made on behalf of an employee while he was a self-employed individual in the business with respect to which the plan was established. For the taxation of such amounts, see § 1.72-18. For the rules for determining the amount attributable to contributions on behalf of an employee while he was self-employed, see paragraphs (b)(4) and (c)(2) of such section.

[T.D. 6500, 25 FR 11681, Nov. 26, 1960, as amended by T.D. 6676, 28 FR 10143, Sept. 17, 1963; T.D. 6722, 29 FR 5073, Apr. 14, 1964]

§ 1.403(b)-1 Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

(a) *Amounts paid by employer during taxable years beginning before January 1, 1958*—(1) *In general.* If an amount is paid during a taxable year of an employee (or a retired or former employee) beginning before January 1, 1958, toward the purchase for such employee of an annuity contract and such purchase is not part of an annuity plan which meets the requirements of section 404(a)(2), then such amount is not required to be included in the gross income of such employee for such taxable year—

(i) If such amount is paid by an employer which, at the time of the payment, is an organization described in section 501(c)(3) and exempt from tax under section 501(a), and

(ii) If the purchase of the annuity contract is merely a supplement to the past or current compensation of such employee (within the meaning of subparagraph (2) of this paragraph).

For purposes of this paragraph, it is immaterial whether or not the employee's rights to the annuity contract are forfeitable.

(2) *Supplement to past or current compensation.* For purposes of this paragraph, whether the purchase of an annuity contract is merely a "supplement to past or current compensation" is to be determined by all the surrounding facts and circumstances. One